

The Management's Discussion and Analysis provides a narrative overview and analysis of the financial activities of the State.

Management's Discussion and Analysis

The following is a discussion and analysis of the State of Missouri's (the State's) financial activities for the fiscal year ended June 30, 2003. Readers are encouraged to consider the information presented here in conjunction with additional information that we have furnished in our letter of transmittal. **All amounts, unless otherwise indicated, are expressed in thousands of dollars.**

HIGHLIGHTS

Highlights of fiscal year 2003 include:

- continued increased funding for the school foundation formula for local schools;
- investments in operating costs for new prisons;
- funding for a prescription drug plan for the elderly;
- an intensive core budget review resulting in \$687 million in core cuts or redirections in fiscal year 2003.

In fiscal year 2003, Missouri invested a total of \$101 million in its capital assets with appropriations for construction and maintenance projects throughout the State. Missouri also invested \$1.127 billion in road and bridge construction and maintenance as part of a long-range plan to improve highways using State gasoline tax revenues and matching federal dollars.

OVERVIEW OF THE FINANCIAL STATEMENTS

This section serves as an introduction to the State's basic financial statements. The State's basic financial statements comprise three components: 1) government-wide financial statements, 2) fund financial statements, and 3) notes to the financial statements. This report also contains other supplementary information in addition to the basic financial statements themselves.

Government-wide financial statements:

The government-wide financial statements are designed to provide readers with a broad overview of the State's finances, in a manner similar to a private-sector business.

The *statement of net assets* presents information on all of the State's assets and liabilities, with the difference between the two reported as *net assets*. Over time, increases or decreases in net assets may serve as a useful indicator of the State's financial position.

The *statement of activities* presents information showing how the government's net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of when the cash is received. Thus, revenues and expenses are reported in the statement for some items that will result in cash flows in future fiscal periods (e.g., uncollected taxes and earned but unused vacation leave).

Both of the government-wide financial statements report three activities:

Governmental Activities are primarily supported by taxes and intergovernmental revenues. They include general government, education, natural and economic resources, transportation and law enforcement, and human services.

Business-Type Activities are intended to recover all or a significant portion of their costs through user fees and charges. They include constructing and operating State park facilities, fairgrounds, historical properties and office buildings, hospital services, warehousing, merchandising, publishing maps and documents, insurance coverage, and the operation of the State Lottery, Unemployment Compensation, and the Petroleum Storage Tank Insurance Fund.

Discretely Presented Component Units are operations for which the State has financial accountability, but are legally separate. They include colleges and universities, the Development Finance Board, Agricultural and Small Business Development Authority, and various highway transportation corporations.

Fund financial statements:

A *fund* is a group of related accounts that is used to keep track of specific activities or objectives. Some funds are required by law, while others are established internally to maintain control over a particular activity. All of the funds of the State can be divided into three categories: governmental, proprietary, and fiduciary funds.

Governmental funds are used to account for essentially the same functions reported as governmental activities in the government-wide financial statements. However, unlike the government-wide financial statements, governmental fund financial statements focus on short-term inflows and outflows of current financial resources, as well as on balances that can be converted to cash and the balances left at year-end that are available for future spending. Such information may be useful in evaluating a government's financing requirements in the near future.

Governmental funds include the General Fund, special revenue, capital projects, debt service, and permanent funds. Of these, the General Fund, Public Education, Conservation and Environmental Protection, Transportation and Law Enforcement, and the State Road Fund are shown as major funds and are presented in separate columns. Data from other governmental funds are combined into a single column for aggregated presentation. Individual fund data for each of these non-major governmental funds is provided in the form of combining statements elsewhere in this report.

In order for the user to compare the information presented for *governmental funds* with similar information presented for *governmental activities* in the government-wide financial statements, a reconciliation to facilitate this comparison between governmental funds and governmental activities is provided on the page immediately following each governmental fund financial statement.

Proprietary funds. The State maintains two different types of proprietary funds. Enterprise funds are used to report the same functions presented as business-type activities in the government-wide financial statements. The State uses enterprise funds to account for activities that provide supplies and services to the general public. These include constructing and operating State park facilities, fairgrounds, historical properties and office buildings, hospital services, warehousing, merchandising, publishing maps and documents, and the operation of the State Lottery, Unemployment Compensation, and the Petroleum Storage Tank Insurance Fund. Internal service funds report activities that provide supplies and services for the State's other programs and activities. The State uses internal service funds to account for insurance and health-care plans, as well as administrative services for other State agencies, such as fleet management and data processing and telecommunication services. Because these services predominately benefit governmental rather than business-type functions, they have been included within governmental activities in the government-wide financial statements.

Proprietary funds provide the same type of information as the government-wide financial statements, only in more detail. The proprietary fund financial statements provide separate information for the State Lottery, Unemployment Compensation, and Petroleum Storage Tank Insurance, which are considered major enterprise funds. All internal service funds are combined into a single column in the proprietary fund financial statements. Individual fund data for the non-major enterprise and internal service funds is provided in the form of combining statements in supplementary information.

Fiduciary funds. Fiduciary funds are used to account for resources held for the benefit of parties outside the state government. Fiduciary funds are *not* reflected in the government-wide financial statement because the resources of those funds are not available to support the State's own programs. The accounting used for fiduciary funds is similar to that used for proprietary funds.

Notes to the financial statements. The notes provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements.

Other information. In addition to the basic financial statements and accompanying notes, this report also presents certain *required supplementary information* including a budgetary comparison schedule.

The combining statements referred to earlier concerning non-major governmental funds, non-major enterprise funds, and internal service funds are presented in supplementary information.

GOVERNMENT-WIDE FINANCIAL ANALYSIS

The State of Missouri completed fiscal year 2003 with a balanced budget. Net general revenue collections in fiscal year 2003 were \$5,926 million, 4.6% lower than fiscal year 2002 collections. Net general revenue collections were lower than the original estimate of \$6,568.7 million.

The fiscal year 2004 budget approved by the general assembly assumes net general revenue collections of \$6,227 million. This would require growth of 5.1% over fiscal year 2003.

As a major manufacturing, financial, and agricultural State, Missouri's economic health is tied closely to that of the nation. The economic outlook is for a slowly growing economy in fiscal year 2004. Missouri's personal income, which directly impacts individual income tax and sales tax, rose at a 2.8% rate during calendar year 2002. Missouri's employment stood at 2,816,812 in June 2003. The State seasonably adjusted unemployment rate was 5.7% in June 2003 compared to 5.6% in June 2002. The national rate was 6.4% in June 2003.

STATEMENT OF NET ASSETS

	Governmental Activities		Business-Type Activities		Total	
	2003	2002*	2003	2002*	2003	2002*
ASSETS:						
Current and Other Assets	\$ 5,232,325	\$ 5,084,813	\$ 290,319	\$ 547,706	\$ 5,522,644	\$ 5,632,519
Capital Assets, Net	27,033,758	26,707,575	34,772	35,510	27,068,530	26,743,085
<i>Total Assets</i>	32,266,083	31,792,388	325,091	583,216	32,591,174	32,375,604
LIABILITIES:						
Long-Term Liabilities						
Outstanding	3,123,575	2,874,762	228,036	202,992	3,351,611	3,077,754
Other Liabilities	1,386,139	1,649,407	16,005	30,619	1,402,144	1,680,026
<i>Total Liabilities</i>	4,509,714	4,524,169	244,041	233,611	4,753,755	4,757,780
NET ASSETS:						
Invested in Capital Assets,						
Net of Related Debt	26,787,048	26,345,659	34,772	35,510	26,821,820	26,381,169
Restricted	1,048,718	998,138	113,109	358,666	1,161,827	1,356,804
Unrestricted	(79,397)	(75,578)	(66,831)	(44,571)	(146,228)	(120,149)
<i>Total Net Assets</i>	\$ 27,756,369	\$ 27,268,219	\$ 81,050	\$ 349,605	\$ 27,837,419	\$ 27,617,824

*Fiscal year 2002 amounts have been restated.

STATEMENT OF ACTIVITIES

	Governmental Activities		Business-Type Activities		Total	
	2003	2002*	2003	2002*	2003	2002*
REVENUES:						
Program Revenues:						
Charges for Services	\$ 1,514,807	\$ 1,699,806	\$ 784,075	\$ 639,070	\$ 2,298,882	\$ 2,338,876
Operating Grants and Contributions	7,195,302	6,425,450	507,832	524,808	7,703,134	6,950,258
Capital Grants and Contributions	9,370	7,722	---	---	9,370	7,722
General Revenues:						
Sales and Use Taxes	2,668,522	2,493,521	---	---	2,668,522	2,493,521
Income Taxes	4,733,323	4,555,621	---	---	4,733,323	4,555,621
Unemployment and Other Taxes	1,528,952	1,360,717	---	---	1,528,952	1,360,717
Other Revenues	70,564	95,616	16,155	24,770	86,719	120,386
<i>Total Revenues</i>	<u>17,720,840</u>	<u>16,638,453</u>	<u>1,308,062</u>	<u>1,188,648</u>	<u>19,028,902</u>	<u>17,827,101</u>
EXPENSES:						
General Government	569,005	871,910	---	---	569,005	871,910
Education	5,302,896	5,298,468	---	---	5,302,896	5,298,468
Natural and Economic	484,046	818,268	---	---	484,046	818,268
Transportation and Law Enforcement	1,858,112	1,909,275	---	---	1,858,112	1,909,275
Human Services	8,490,784	8,093,552	---	---	8,490,784	8,093,552
State Lottery	---	---	521,340	433,265	521,340	433,265
Unemployment Compensation	---	---	747,531	642,045	747,531	642,045
Petroleum Storage Tank	---	---	49,012	25,915	49,012	25,915
All Other Expenses	728,511	698,630	58,070	52,556	786,581	751,186
<i>Total Expenses</i>	<u>17,433,354</u>	<u>17,690,103</u>	<u>1,375,953</u>	<u>1,153,781</u>	<u>18,809,307</u>	<u>18,843,884</u>
Increase (Decrease) in Net Assets before Contributions and Transfers	287,486	(1,051,650)	(67,891)	34,867	219,595	(1,016,783)
<i>Transfers</i>	<u>200,664</u>	<u>156,012</u>	<u>(200,664)</u>	<u>(156,012)</u>	<u>---</u>	<u>---</u>
Change in Net Assets	488,150	(895,638)	(268,555)	(121,145)	219,595	(1,016,783)
<i>Net Assets—July 1</i>	<u>27,268,219</u>	<u>28,163,857</u>	<u>349,605</u>	<u>470,750</u>	<u>27,617,824</u>	<u>28,634,607</u>
<i>Net Assets—June 30</i>	<u>\$ 27,756,369</u>	<u>\$ 27,268,219</u>	<u>\$ 81,050</u>	<u>\$ 349,605</u>	<u>\$ 27,837,419</u>	<u>\$ 27,617,824</u>

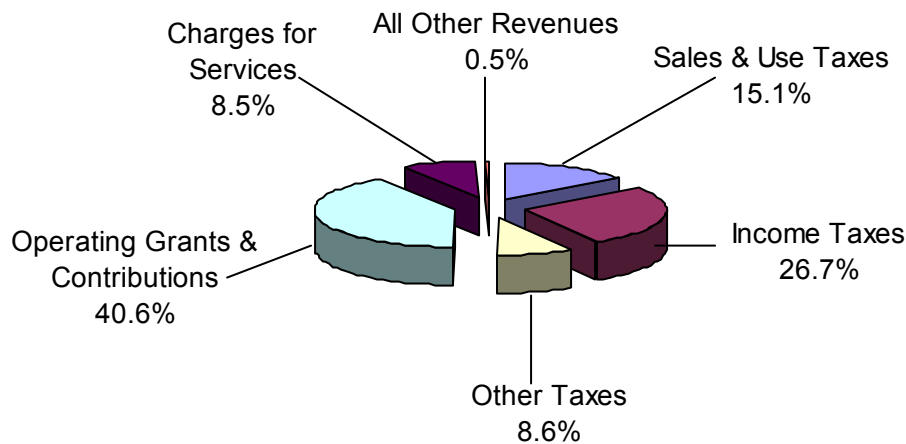
*Fiscal year 2002 amounts have been restated.

Governmental Activities:

Governmental activities increased the State's net assets by \$488 million due to increases in individual income tax revenue, donations, and contributions from the federal government and decreases in general government and natural and economic expenditures. Individual income taxes increased by \$200 million and donations and contributions from the federal government increased by \$772 million. General government and natural and economic expenditures decreased by \$637 million which was offset by \$397 million increase of human service expenditures.

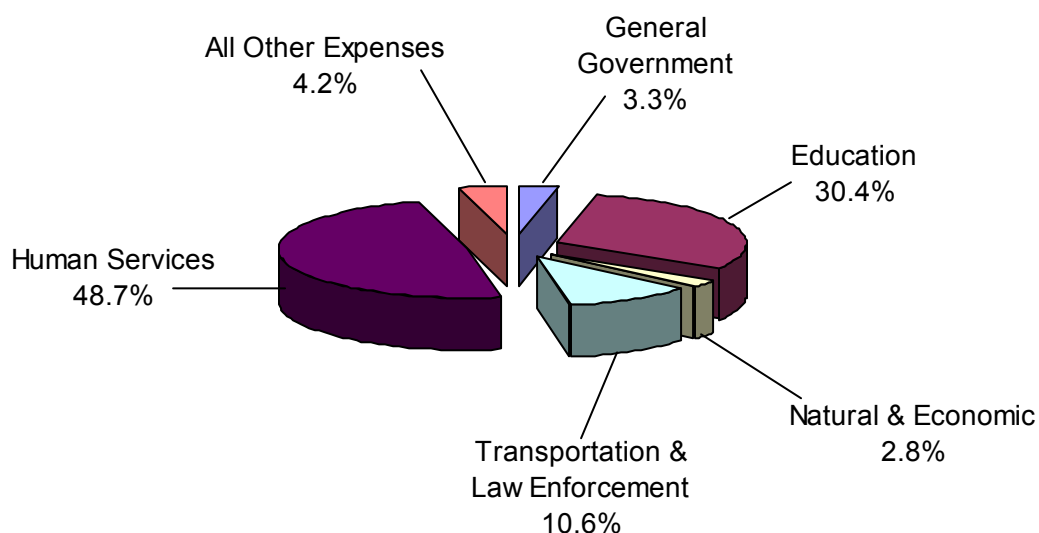
The following chart depicts revenues of the governmental activities for the fiscal year:

Revenues by Source



The following chart depicts expenses of the governmental activities for the fiscal year:

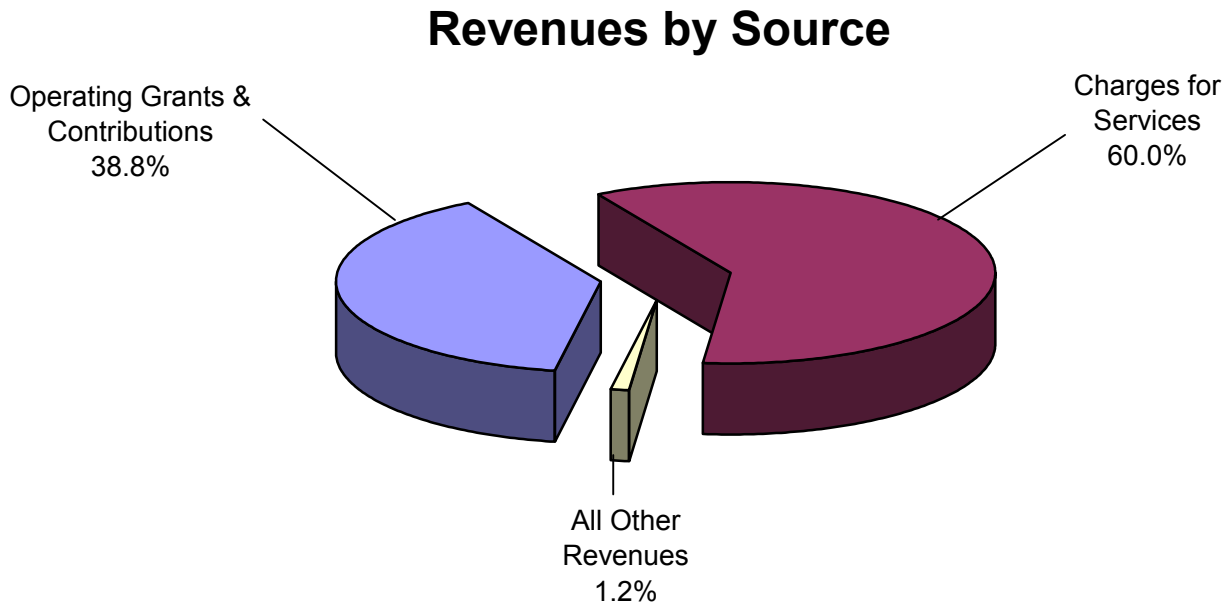
Expenses by Function



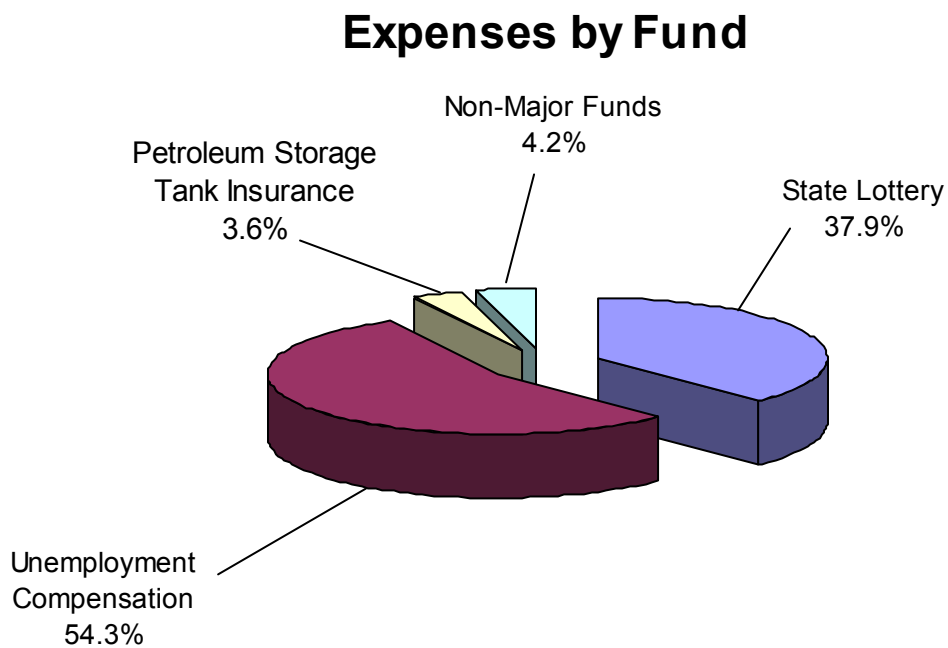
Business-Type Activities:

Net assets of the business-type activities decreased by \$269 million during the fiscal year. Factors contributing to these results include increased spending for unemployment compensation and a decline in revenues from operating grants and other revenues.

The following chart depicts revenues of the business-type activities for the fiscal year:



The following chart depicts expenses of the business-type activities for the fiscal year:



FINANCIAL ANALYSIS OF THE STATE'S FUNDS

The State uses fund accounting to ensure and demonstrate compliance with statutory requirements for financial reporting.

Governmental Funds:

As of the end of fiscal year 2003, the State's governmental funds reported combined ending fund balances of \$3.16 billion, an increase of \$67.7 million over fiscal year 2002. Approximately 62.9% of this amount constitutes unreserved fund balance, which is available for spending at the government's discretion. The remainder of fund balance is reserved to indicate that it is not available for new spending because it has already been committed: 1) for budget reserve, 2) to pay debt service, 3) for loans receivable, and 4) for a variety of other restricted purposes.

The general fund is the chief operating fund of the State. At the end of fiscal year 2003, unreserved fund balance of the general fund was \$476.8 million, while total fund balance reached \$1.0 billion. As a measure of the general fund's liquidity, it may be useful to compare both unreserved fund balance and total fund balance to total fund expenditures. Unreserved fund balance represents 4.2% of the total general fund expenditures, while total fund balance represents 9.1% of that same amount.

The fund balance of the general fund increased by \$127 million during fiscal year 2003. Total revenues for the general fund increased \$496 million. A key factor was an increase in contributions and intergovernmental revenue of \$731 million from fiscal year 2002. Total general fund expenditures increased by \$1.3 billion. This is the result of an increase in human services expenditures of \$487 million and an increase in education expenditures of \$700 million, while other expenditure categories showed lesser increases. The rate at which expenditures increased was limited through the Governor's use of withholdings as needed to match the revised revenue estimates and maintain a balanced budget.

Major Special Revenue Fund categories include Public Education, Conservation and Environmental Protection, and Transportation and Law Enforcement. The State Road Fund is a major Capital Projects Fund.

The Public Education Fund category provides general and special education needs of the State and other related areas such as library services and student loans. Total fund balance decreased by \$124 million due to an increase in expenditures.

Conservation and Environmental Protection Fund category provides for the preservation of the State's wildlife and environment. The fund balance increased by \$98 million due to increases in taxes and contributions and intergovernmental revenue. Fund balance in the amount of \$437 million is reserved for loans receivable.

Transportation and Law Enforcement Fund category provides transportation services, road construction and maintenance, and the enforcement of vehicle laws and traffic safety. The fund balance decreased by \$23 million due to an increase in transfers to the State Road Fund.

The State Road Fund accounts for revenues from highway users' fees, federal reimbursements for highway projects, and bond proceeds to be used for costs of constructing and maintaining an adequate state highway system. The fund balance decreased by \$136 million in fiscal year 2003 due to a decrease in contributions and intergovernmental revenue and an increase in debt service expenditures.

Fund balances for governmental funds are as follows:

	General Fund	Public Education	Conservation and Environmental Protection	Transportation and Law Enforcement	State Road	Non- Major	Total
Unreserved	\$ 476,825	\$ 176,322	\$ 418,396	\$ 109,456	\$ 283,236	\$ 525,793	\$ 1,990,028
Reserved	557,217	58	437,587	7,052	25,750	146,650	1,174,314
Total	\$ 1,034,042	\$ 176,380	\$ 855,983	\$ 116,508	\$ 308,986	\$ 672,443	\$ 3,164,342

Proprietary Funds:

The State has three major proprietary funds: State Lottery, Unemployment Compensation, and the Petroleum Storage Tank Insurance Fund. The State Lottery accounts for the sale of lottery tickets and all other moneys credited or transferred to this fund. The Unemployment Compensation accounts for contributions and payments collected under the provision of the "Unemployment Compensation Law" to pay benefits. The Petroleum Storage Tank Insurance fund accounts for moneys collected from transport load fees and participating owners of petroleum storage tanks for cleanup of contamination caused by releases from petroleum storage tanks.

The State Lottery net assets increased by \$5 million due to increased sales and other revenues.

The Unemployment Compensation net assets decreased by \$251 million due to additional payments for benefits and a decrease in contributions and intergovernmental revenues. Net assets in the amount of \$97 million are restricted for unemployment compensation.

The Petroleum Storage Tank Insurance Fund balance decreased by \$24 million due to insufficient fees collected to cover the estimated claims liability for clean up of petroleum storage tank leaks.

GENERAL FUND BUDGETARY HIGHLIGHTS

The original budget is the first complete appropriated budget that is truly agreed to and finally passed, and signed by the Governor. The final budget includes emergency and supplemental appropriations, transfers, and increases to appropriations.

Budgeted appropriations for fiscal year 2003 from the general fund were \$15,283 million original budget and \$15,257 million revised budget. Actual spending was \$14,436 million. The two main reasons for the difference were decreased spending as a result of withholdings of \$450.1 million and increased spending of \$88.2 million, mainly on mandatory Medicaid costs, through the supplemental spending bill. The withholdings were put in place not only to deal with the projected revenue shortfall, but also to make sure sufficient funds were available to pay the mandatory supplemental costs.

Budgeted revenues/transfers in for fiscal year 2003 for the general fund was \$14,514 million original budget and \$14,122 million revised budget. Actual revenue/transfers in was \$14,469 million. The main reasons for the difference were:

- A second year of weak stock market performance.
- Continued weakness in the national economy made worse by concerns over the Iraq situation.
- Lingering weakness in the Missouri airline and aerospace industries stemming from the September 11, 2001 terrorist attack.

Refer to the Notes to RSI, Budgetary Reporting, for more information on budgetary variances.

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital Assets. The State's investment in capital assets for its governmental and business-type activities as of June 30, 2003, amounts to \$27,068,530 (net of accumulated depreciation). This investment in capital assets includes construction in progress, infrastructure in progress, land, land improvements, buildings and improvements, equipment, and infrastructure. The total increase in the State's investment in capital assets for the current fiscal year was 1.2%.

	Governmental Activities	Business-Type Activities	Total
Construction in Progress	\$ 686,489	\$ 2,590	\$ 689,079
Infrastructure in Progress	2,563,943	---	2,563,943
Land	2,336,674	10,563	2,347,237
Land Improvements	76,877	3,405	80,282
Buildings and Improvements	1,865,267	15,999	1,881,266
Equipment	1,108,724	44,644	1,153,368
Infrastructure	36,638,118	---	36,638,118
Total	\$ 45,276,092	\$ 77,201	\$ 45,353,293

Additional information on capital assets can be found in *Note 5* of this report.

Long-term debt. At the end of fiscal year 2003, the State had total bonded debt outstanding of \$3.2 billion. Of this amount, \$900.7 million comprises debt backed by the full faith and credit of the government.

During fiscal year 2003, \$514,180,000 of General Obligation Refunding Bonds were issued to refund \$530,075,000 of General Obligation Bonds and to take advantage of lower interest rates. New General Obligation Bonds and Other Revenue Bonds were issued in the amounts of \$45,000,000 and \$387,425,000, respectively. Principal amounts retired in fiscal year 2003 were \$52,155,000 for General Obligation Bonds and \$30,885,000 for Other Revenue Bonds.

	Governmental Activities	Component Units	Total
General Obligation Bonds	\$ 900,745	\$ ---	\$ 900,745
Other Bonds	1,410,955	835,280	2,246,235
Total	\$ 2,311,700	\$ 835,280	\$ 3,146,980

Additional information on long-term debt can be found in *Notes 12 and 13* of this report.

ECONOMIC OUTLOOK AND NEXT YEAR'S BUDGET

The outlook for general revenue growth for fiscal year 2004 and beyond remains guarded. This is because there are several factors that will negatively impact general revenue. These include:

- A decline in general revenue due to the Jobs and Growth Tax Relief Reconciliation Act of 2003.
- Uncertainty over the magnitude and timing of tax credit utilization.
- Additional uncertainty with respect to the pace of the national economic recovery in general and the growth in stock prices in particular.
- International Relations – A terrorist attack against the United States or its interests or a disruption in world oil markets could seriously inhibit economic growth and lead to reduced state general revenue collections.

In summary, while general revenue collections are expected to stabilize in fiscal year 2004 and beyond, there remains substantial risk.

Events taking place after the State's fiscal year end include:

- The Governor asked for drought relief from the U.S. Department of Agriculture for 39 counties in Missouri. Farmers are facing crop and livestock losses for the second straight year because of drought conditions.
- The Missouri Department of Economic Development's Division of Workforce Development was notified in July that National Emergency Grant funds had been approved for approximately 340 workers dislocated from the St. Louis area, and approximately 800 workers in the south central and mid-Missouri regions.
- A disaster recovery fund was created by the Department of Economic Development to help provide long term relief to communities, businesses, and families that sustained damages from a series of tornadoes and severe storms last May. More than 70 counties were designated as disaster areas by the Federal Emergency Management Agency.
- State tax credits will be given to community-based organizations throughout the State to help raise funds for projects that strengthen and revitalize Missouri neighborhoods.
- After 26 years of costly litigation, the Kansas City School District's \$2 billion federal desegregation case ended in September.

REQUESTS FOR INFORMATION

This financial report is designed to provide a general overview of the State's finances for all those with an interest in the government's finances. Questions concerning any of the information provided in this report or request for additional financial information should be addressed to the Office of Administration, Division of Accounting, P.O. Box 809, Jefferson City, MO 65102.